STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PUBLIC UTILITIES COMMISSION

IN RE: VALLEY GAS COMPANY\
BRISTOL & WARREN GAS COMPANY
ANNUAL PURCHASED GAS
ADJUSTMENT CLAUSE FILING

DOCKET NO. 1736

REPORT AND ORDER

On August 30, 1999, the Valley Gas Company/Bristol & Warren Gas Company (together, "Valley" or "Company") filed with the Public Utilities Commission ("Commission") a request to raise its purchased gas price adjustment ("PGPA") clause factor for tariff No. 100 from $0.285 per Mcf to $0.652 per Mcf, an increase of $0.367 per Mcf. This would increase the average residential heating customer's bill by $33.11 per annum, to be effective with cycle billings in October, 1999.[1] The filing was suspended on September 28, 1999, to permit the Division of Public Utilities and Carriers ("Division") to complete discovery regarding the PGPA.

Following notice, a public hearing was conducted at the offices of the Commission, 100 Orange Street, Providence, on September 29, 1999. The following appearances were entered:

FOR THE COMPANY: Deming Sherman, Esq.

FOR THE DIVISION: Paul J. Roberti
Assistant Attorney General

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[1] The Company's PGPA Tariff requires the revised PGPA factor to be filed for effect as of September 1 of each year. However, the Commission granted Valley's request to defer its 1999 PGPA filing to August 30, 1999, thereby deferring the requested effective date of the revised PGPA factor to October 1, 1999.

FOR OSRAM SYLVANIA: Gregory Benik, Esq.

FOR THE COMMISSION: Adrienne G. Southgate
General Counsel

Public comments were received from Antonio Lopresti of the Gray Panthers, Henry Shelton of the George Wiley Center, and Savino Salerno.

The hearings reconvened on October 21, 1999, with the same attorneys present. Public comment was additionally received from Margaret Rogers, representing the Campaign Against Childhood Poverty.

The Company called Thomas Philbin, the Company's controller.[2] In his prefiled testimony and exhibits, Mr. Philbin described Valley's proposal to more than double its PGPA. At the hearing, Mr. Philbin provided revised figures as to the PGPA deferred gas cost account balance, which was estimated as a $70,268 undercollection at the end of September 1999[3]; the revised figure is an overcollection of $94,253, which is expected to grow through the implementation date of the new factor.[4] The witness estimated that this would amount to roughly two cents per Mcf on the PGPA recovery.[5]

The second witness was Alan H. Roy, Valley's assistant vice-president of gas supply.[6] Mr. Roy explained that gas costs are basically predicated on developments in the national and regional markets. However, when forecasts are made, the Company takes the prices established at NYMEX and translates these into costs for its customers by adding and

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2 Mr. Philbin's prefiled testimony and exhibits were admitted as Valley Ex. 1.

3 See Valley Ex. 1, p.3

4 T. 10/21/99, p. 22.

5 Ibid., pp. 27-28.

6 Mr. Roy's prefiled testimony and exhibits were admitted as Valley Ex. 2.

subtracting various other costs, including transportation and fuel.[7] The NYMEX futures prices from September through August 2000 project gas cost increases of 46 cents per Mcf overall. Valley has been able to save about 11 cents per Mcf, but replacing some of this winter-only gas adds roughly 4 cents per Mcf for the PGPA period.[8] In addition, underground gas storage costs are projected to increase significantly. Mr. Roy explained that, in his opinion, three complementary, market-related factors drove up the price of wellhead gas: wellhead prices jumped nearly thirty cents per million Btus from March to April, leading many local distribution companies to slow their injections into underground storage; predictions of a severe hurricane season accelerated the price increase; and expectations are that the upcoming winter will be "normal" rather than warmer than average.[9] Mr. Roy added that gas drilling rig counts have declined precipitously, from 601 in April 1998, to 369 this past April.[10]

Mr. Roy conceded that the Company had underestimated the strength of the market. However, Valley subscribed to a gas pricing forecast by Risk Management, Inc. ("RMI"), which was not on target in its predictions.[11]

During cross-examination by counsel for intervenor OSRAM SYLVANIA Products, Inc. ("OSRAM"), Valley's largest customer, Mr. Roy explained the various options for purchasing gas, including fixed contracts, purchases on the cash or spot market,

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7 Ibid., p. 30.

8 See Valley Ex. 2, p. 1.

9 Ibid., pp. 2-3.

10 Ibid., p. 3.

11 Ibid., pp. 3-4.

and various hedging options (collars, puts and calls).[12] Mr. Roy said Valley has exclusively purchased its gas supply on the monthly spot market, predicated on the prices for that particular month. However, he reminded everyone that roughly 38% of Valley's gas costs are embedded, including its underground storage gas and the Liquified Natural Gas ("LNG") used for peak supply.[13] With regard to the remaining 62% of Valley's gas costs that are subject to spot market price fluctuations, Mr. Roy testified that the impending delivery of gas supply via the new Maritimes & Northeast Pipeline was very important to Valley's determination not to fix prices.[14]

Mr. Roy acknowledged that Valley had adopted a risk management policy relating to gas procurement in November 1997, but the policy was never implemented.[15] He explained that the Company received five proposals from potential fixed price vendors, but after careful evaluation and modeling, determined that the Company's in-house procurement results were preferable.[16] Subsequently, Valley continued negotiations with several of these vendors; it continues to have discussions with Aquila, Inventory Management Design, and TPC.[17] The witness stated that both outsourcing and fixed pricing increases costs dramatically.[18]

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[12] T. 10/21/99, pp. 34-36.

[13] Ibid., pp. 39-40.

[14] Ibid., pp. 41, 43.

[15] Ibid., pp. 78-79.

[16] Ibid., p. 79.

[17] Ibid., p. 81.

[18] Ibid., pp. 82, 94.

Following a recess, the parties advised that they had reached agreement, reflected in an "Outline of Incentive Structure for Gas Price Stability" memorandum submitted by Mr. Roberti.[19]

To explain the settlement, the Division called Bruce R. Oliver. Mr. Oliver testified that the Division's initial concern was that Valley had locked in prices only for its propane, LNG and storage gas, while the bulk of its gas supply would be received over the pipelines in a procurement strategy relying almost exclusively on the spot market.[20] The Division had been encouraging the Company to consider a procurement strategy which would help insulate customers from unexpected price increases or large fluctuations in price.[21] With stability in price an important objective, the parties ultimately agreed to an outline for an incentive structure incorporating a symmetrical risk/benefit sharing mechanism.[22]

The parties accepted the Company's average gas cost projection for the current PGPA period of $4.23 per Mcf. Around this projected average cost, a plus or minus 10% "dead band" is allowed, creating an upper bound of $4.65 per Mcf and a lower bound of $3.80 per Mcf.. Valley will recover 100 % of its gas costs incurred within the dead band as currently provided for under the PGPA Tariff. However, recovery of any actual average gas costs[23] outside the bounds of the dead band will be subject to an incentive plan which incorporates a risk/reward sharing mechanism for the Company and its ratepayers.

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[19] The memorandum, Division Ex. 1, is attached and incorporated by reference as Appendix A.

[20] Ibid., pp. 104-105.

[21] Ibid., p. 105.

[22] Ibid., p. 108.

[23] In a letter addressed to Stephen Scialabba, the Division's Chief Accountant, on October 27, 1999, the Company agreed to calculate its actual procurement cost of gas

If the actual average gas cost for the current PGPA period exceeds $4.65 per Mcf, the Company is at risk to absorb 20% of the excess cost, with ratepayers only at risk for the remaining 80%. Conversely, if the actual average gas cost for the current PGPA period is below $3.80 per Mcf, the Company will be entitled to an incentive reward of 20% of the cost savings, and ratepayers will receive the benefit of the remaining 80% of the cost savings. The maximum annual risk or reward for the Company under this incentive arrangement is $400,000, which amount is equivalent to approximately 10% of the Company's earnings before interest and taxes, or approximately 30% of its overall return on equity.[24] Any incentive reward earned by the Company in the current PGPA period will be recovered through the PGPA factor established for the ensuing PGPA year.[25]

The incentive arrangement is expressly limited to the current PGPA period only, although Mr. Oliver noted that negotiations continue with a view to further adding stability to the Company's costs of gas in future periods.[26]

In response to cross-examination from the bench, Mr. Oliver said that he did not envision the establishment of a low-income assistance program within the PGPA mechanism.[27] He pointed out that assessing only firm sales customers in order to fund

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based upon the eleven month period from October 1, 1999 through August 31, 2000, which will become the incentive period for the ensuing PGPA year.

[24] Ibid., p. 111.

[25] Ibid., p 110.

[26] Ibid., p. 112.

[27] Ibid., p. 115.

such a program would be fundamentally unfair, and suggested that a better alternative would be to recover the costs of such a program over all throughput.[28]

On behalf of OSRAM, plant manager Steve Sander made some remarks regarding his company's unique competitive positions and the importance of the PGPA proceedings. He noted that the new PGPA factor would increase OSRAM's gas costs by $135,000 to $150,000 per annum.[29]

At an open meeting on October 27, 1999, the Commission considered the filing and found the proposed PGPA factor to be reasonable, supported by the evidence, and in compliance with the Company's tariff. The Commission further agreed that the incentive structure proposed by the parties was an appropriate means of encouraging Valley to take greater steps to insure gas price stability, and adopted it as filed.

Accordingly, it is

(16031) ORDERED:

1. The PGPA factor for Valley Gas Company\ Bristol & Warren Gas Company will be set at $0.652 per Mcf, effective with cycle billings in November, 1999.

2. The "Outline of Incentive Structure for Gas Price Stability" is hereby adopted as filed for effect during the current PGPA period.

[28] Ibid.. p. 116. This is what the Commission ultimately did in approving the Company's Supplemental Low Income Assistance Plan in Docket No. 3030. See Order No. 16063 (issued November 30, 1999).

[29] Ibid., p. 135.

EFFECTIVE AT PROVIDENCE, RHODE ISLAND PURSUANT TO AN OPEN MEETING DECISION ON OCTOBER 27, 1999. WRITTEN ORDER ISSUED JANUARY 18, 2000.

PUBLIC UTILITIES COMMISSION

Kate F. Racine, Commissioner

Brenda K. Gaynor, Commissioner